BEFORE THE
SURFACE TRANSPORTATION BOARD

Ex Parte No. 705

COMPETITION IN THE RAILROAD INDUSTRY

REPLY COMMENTS OF
WESTLAKE CHEMICAL CORPORATION

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REPLY COMMENTS OF WESTLAKE CHEMICAL CORPORATION

In its Notice served January 11, 2011 in this proceeding, the Surface Transportation Board ("Board") so ught comments on various issues of great importance to the railroad industry, rail shippers, and the general economy. 76 Fed. Reg. 2748 (Jan. 14, 2011). Westlake Chemical Corporation (together with its subsidiaries, "Westla ke") submitted Initial Comments on April 12, 2011. Westlake now submits these Reply Comments in response to the Notice.

Overview

As Westlake stated in its Initial Comments, but which bears repeating in view of the arguments of most of the Class I railroads for retention of the status quo, the Staggers Rail Act of 1980 ("the Staggers Act") supports and encourages the existence of rail-to-rail competition in the marketplace. One of its policies is "To ensure t he development and continuation of a sound rail transportation system with effective competition among rail carriers and with other modes, to meet the needs of the public and the national defense." This policy is supported by two other policy statements: "To reduc e regulatory barriers to entry and exit from the industry," and "... to avoid undue concentrations of market power...." These policies are consistent with one of the findings of Congress in the Staggers Act, which is that "Great er reliance on the marketplace is essential in order to achieve maximum utilization of railroads to save energy and combat inflation."

Unfortunately, these policies were largely not achieved, because the ICC (and later the STB, at least until recent years) concentrated primarily on the alleged revenue needs of the "revenue-inadequate" railroads, while permitting many of them to merge or acquire large portions of other railroad systems. Each of the issues that the Board commendably has posed in this proceeding involves a policy determination that favored the railroads' interests over the shippers' interests; that is why the railroads support the status quo. But the Staggers Act supported competition, and a balance, between the interests of the shippers and the railroads. The Board has discretion in how it carries out these competing policies.

Moreover, the Board's annual revenue-adequacy findings have mostly led to the conclusion that each of the Class I railroads was or is "revenue-inadequate," with only occasional exceptions in a given year. Westlake believes that a proper measure of the railroads' financial circumstances would lead to the conclusion that at least the Class I railroads have been "revenue-adequate" for some time, and are today. After all, the statutory test is whether the railroads are able to "attract capital," and that test is clearly now met, and has been for more than a decade (when railroads attracted capital for their ambitious mergers and acquisitions). Indeed, railroads are now typically so profitable, and confident that the future will be even rosier than the past, that they are engaged in significant "buy-backs" of their stocks. The latest example was CSX's $2 billion buyback, announced in early May 2011. Yet, in some quarters, CSX is perceived as the weakest of the " Big Four" Class I railroads.

The mergers and acquisitions have actually permitted the opposite of what Congress intended in the Staggers Act: a lack of "eff ective competition among rail carriers and with other modes, to meet the needs of the public and the national defense," "to r educe regulatory barriers to entry ... into the industry," and "to avoid undue concentrations of market power."

So, Westlake commends the Board for initiating this proceeding to consider whether it is necessary or appropriate to change any of the Board's existing policies insofar as they affect rail-to-rail competition or any of the other subjects addressed in the Board's N otice.

Westlake filed extensive Initial Comments, as did the "Interest ed Parties." Westlake is also aware that the same "Interest ed Parties" are filing substantial Reply Comments. Westlake incorporates those Reply Comments herein, and emphasizes below the matters of particular importance and interest to Westlake.

I.

THE BOARD HAS THE AUTHORITY TO CHANGE ITS POLICIES.

As a preliminary matter, the railroads made the very argument that Westlake anticipated (Initial Comments at 16 n.7), that the Board lacks the <u>power</u> to change any of its existing policies, because Congress supposedly ratified all of those policies in enacting the Interstate Commerce Commission

Termination Act of 1995 without making many changes to the substantive policies of the ICC. The railroads are incorrect; this argument was anticipated (because the railroads made the same argument in the Ex Parte No. 704 proceeding), and Westlake respectfully refers the Board to its Initial Comments for the entirety of its affirmative argument.

However, for context, some of what follows is repeated for the Board's con venience. First, the Board is free to revise its rules and policies unless Congress has precluded it from doing so. *Chevron U.S.A. Inc. v. Natural Resources Def. Council, Inc.,* 467 U.S. 837, 863 (1984)("An initial agency interpretation is not instantly carved in stone."). The Board may change its policies, to the extent that the Interstate Commerce Act permits, so long as it acknowledges its prior policy and provides a reasoned basis for the changed policy. *E.g., Greater Boston Television Corp. v. FCC,* 444 F.2d 841, 852 (D.C. Cir.), *cert. denied,* 403 U.S. 923 (1971) ("[a]n a gency changing its course must supply a reasoned analysis indicating that prior policies and standards are being deliberately changed, not casually ignored...").

Some of the railroads and their trade association, such as CSX and AAR,[1] rely on *Bob Jones University v. United States,* 461 U.S. 574 (1983), for the supposed proposition that "Con gress endorses regulatory policy when it knows of statutory interpretation and declines to change the

[1] Initial Comments of AAR at 31-32; Opening Comments of CSX Transportation, Inc. at 10.

statute." *Bob Jones University* does not stand for that proposition. On the contrary, the Supreme Court said, at the very page cited by CSX (*id.* at 600), "Ordinarily, a nd quite appropriately, courts are slow to attribute significance to the failure of Congress to act on particular legislation," *citing, e.g., Aaron v. SEC,* 446 U.S. 80, 694 n.11 (1980). Indeed, the Court added (in *Bob Jones University)* that "We have observed that 'unsu ccessful attempts at legislation are not the best of guides to legislative intent," *id., citing Red Lion Broadcasting Co. v. FCC,* 395 U.S. 367, 382 n. 11 (1969).

The Court went on to explain that it drew an inference about Congressional inaction in the *Bob Jones* case because, in that case, Congress had, in fact, enacted legislation, <u>including amending the specific section in question</u>, without addressing the administrative interpretation at issue there. When Congress acts to amend a statute substantively, but does not make substantive changes sought by one side, an inference can be drawn. Our facts are different.

Since the Staggers Rail Act of 1980 was enacted, the only significant legislation amending the Interstate Commerce Act was the Interstate Commerce Commission Termination Act of 1995, which was intended <u>not</u> to make substantive changes to the Interstate Commerce Act (with only a few notable exceptions, such as a change that was necessary to give the STB authority the U.S. Court of Appeals held that it previously lacked to promulgate simplified rate-reasonableness guidelines). So, AAR's and

CSX's relianc e on *Bob Jones* is way off the mark and inappropriate, just as was NS's relianc e on that case in the pending Ex Parte No. 704 proceeding concerning exemptions. The Board should not be dissuaded by such an erroneous argument from amending its policies because of changed circumstances or its different views of policy matters.

So, as the Supreme Court's decisio ns teach, the fact that Congress has not yet enacted STB reform legislation is of no consequence to the issue of the Board's existi ng authority to alter its policies so long as it adheres to the language and purposes of the Staggers Act. The railroads' argument is entirely without merit, as a strictly legal matter.

The railroads' ar gument is further invalidated for other reasons. First, the STB itself has, subsequent to the enactment of the ICCTA, changed some of its substantive policies, such as (a) eliminating, for the most part, consideration of product and geographic competition in "mar ket dominance" determinations, which the D.C. Circuit affirmed,[2] and (b) determining for the first time that "bottle neck rates" did not have to be quoted unless the non-"bottlene ck carrier" has entered into a contract with the shipper, which the Eighth Circuit affirmed, but indicated that it could well have upheld the opposite interpretation as a matter of the Board's discr etion.[3]

[2] *Association of American Railroads v. STB,* 306 F.3d 1108 (D.C. Cir. 2002).

[3] *MidAmerican Energy Co. v. Union Pacific R.R.,* 169 F.3d 1099, 1107 (8th Cir.) ("Reg ardless of how we would resolve the tension in the Act if we

Second, past Chairmen of the STB have told Congress that they did not need legislation to be enacted of the sort Chairman Rockefeller and Ranking Member Hutchison are now championing, because the STB had the authority necessary to implement the pro-competitive policies of the Staggers Act, and that at least some of the shippers' le gitimate concerns could be dealt with under that authority.[4] Obviously, the STB has ample authority to carry out the pro-competitive policies of the Staggers Act.

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were to independently rule on the utilities' claims, we cannot say that the Board's interpr etation was incorrect."), *cert. denied,* 528 U.S. 950 (1999).

[4] Senate Commerce, Science and Transportation Committee Hearing on Railroad Shipper Issues and S. 919, the Railroad Competition Act of 2003 (Oct. 23, 2003) at 20 (emphasis added):

> "Senator BURNS. While we h ave got you on the hot seat, we might as well leave you right there. Mr. Nober, there is a quote here that is sort of made by you that has some of us sort of-gave us some anxious moments. I quote from you: " Look, I am not going to insult your intelligence and tell you I could not change, that our board could not interpret some of the core rulings that you want us to make a change." Y ou were talking to some shippers. ' 'We could, but we are not going to."
> Could that be the core of our problem here? Would you like to revise and extend?
> Mr. NOBER. Certainly, Senator. In my testimony I did, I acknowledged that that is true, that the doctrines that many of the shippers would like to see changed, which are <u>our bottleneck doctrine and our Midtek [sic: MidTec] or terminal trackage rights doctrine, are administrative doctrines and as a matter of law an administrative agency can change administrative doctrines. Not everyone on our board has always acknowledged that but I as a student of Congress will tell you that we certainly can. Now, whether or not we should and we would are different questions."</u>

See also Testimony of Linda J. Morgan, Chairman of the Surface Transportation Board, Senate Committee on Commerce, Science, and Transportation, Subcommittee on Surface Transportation and Merchant

Finally, no administrative agency should consider itself in a straight-jacket, so that it might never change any of its policies, despite changes in circumstance such as have occurred in the railroad industry since 1980, unless Congress has not provided the agency with any discretion to respond to changed circumstances. Generally speaking, Congress does not impose such constraints, and it did not impose such constraints on the STB.[5]

Marine, Hearing on the Surface Transportation Board, March 21, 2001 ("I recognize that there are those who believe that the Board has not done enough in certain areas, particularly in the matters of small shipper remedies, labor matters, bottleneck relief, and open access. As I have outlined in my testimony today, and as I stated in my December 12, 1998 letter to this Committee, I believe that the Board has done what it can under its current statutory authority and has moved issues in new and positive directions.")(emphasis added). The testimony is accessible on the Board's website:
http://www.stb.dot.gov/TestAndSpeech.nsf/219d1aee5889780b85256e59005edefe/ee6e742f96e1320985256a160065a34f?OpenDocument
This sort of testimony would explain why at least some Members of Congress would have concluded that new legislation was not needed, because Chairman Nober indicated that he did have authority to change the STB's rules and polic ies, and Chairman Morgan agreed that the Board was not powerless to change its interpretation pre-ICCTA.

[5] Westlake does not mean to suggest that the Board can do anything it considers appropriate. The Board could not, for example, alter the 180% R/VC jurisdictional threshold on rate prescriptions, because that provision is specific and clear. However, much of the statute is written using words such as "m ay," signifying that the Board has discretion in how it implements the Act. Each of the cases cited by the AAR as defining the Board's competitive-access rules – *Baltimore Gas & Electric Co. v. ICC,* 817 F.2d 108 (D.C. Cir. 1987), *MidTec Paper Corp. v. United States,* 857 F.2d 1487 (D.C. Cir. 1988), *and MidAmerican Energy Co. v. STB,* 169 F.2d 1099, 1107 (8th Cir. 1999), contain language indicating that the Court was deferring to the ICC's or STB's reasonabl e construction of the statute, rather than that the outcome was compelled by the statute.

Accordingly, the Board should reject the argument of the railroads that it lacks the power to change any of its current policies, as contrary to law, logic, and precedent.

II.

THE RAILROADS' A RGUMENT THAT REGULATION IS SUPERIOR TO COMPETITION IS ENTIRELY INCONSISTENT WITH CONGRESSIONAL INTENT IN THE STAGGERS RAIL ACT OF 1980.

The Association of American Railroads (" AAR") makes the remarkable argument that "The advocates of involuntary access cannot explain why shippers should be entitled to pursue rate reductions through expanded access regulation when rate reasonableness remedies are readily available." AAR Comments at 13. Contrary to AAR's incredible claim, Congress clearly intended that competition, <u>not</u> regulation, be the means of determining rail rates to the maximum extent possible, as the very first policy of Congress (49 U.S.C. § 10101(1) states: "In regulating the railroad industry, it is the policy of the United States Government – (1) to allow, to the maximum extent possible, competition and the demand for services to establish reasonable rates for transportation by rail..."

The Board will have observed that Westlake rarely has invoked the Board's proc esses, preferring competition in the marketplace (to the extent there is any), rather than regulation, to determine the commercial terms of its rail service.[7] It appears from Comments such as AAR's, an d those of BNSF Railway Company, that it is, ironically, the railroads who prefer the current regulatory regime, rather than the shippers that regulation was intended to protect. That speaks volumes about the uneven playing field in current railroad regulation.

Westlake urges the Board to implement the Rail Transportation Policy by adopting pro-competitive approaches to each of the issues on which the Board sought comment herein. Westlake discussed such approaches in its Initial Comments filed on April 12, 2011, and will not repeat what it said there, in the interest of brevity.

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[7] An exception involved rail service to North American Pipe Corporation's facility in Janesville, WI, which Westlake supplies with polyvinyl chloride ("PVC"). Westla ke was advised by Wisconsin & Southern Railroad, whose Janesville Yard abuts NAPCO's facility, th at it could serve NAPCO. However, when Westlake availed itself of WSOR's service, th e Dakota, Minnesota & Eastern Railroad actually placed a lock on the switch into the facility so that only DM&E could serve the facility. Westlake availed itself of the Board's m ediation service, and in response to Westlake's i nformal complaint, DM&E's c ounsel claimed the placement of the lock on the switch was an error by a low-level employee that would not be repeated. Indeed, the lock was removed, for which Westlake credits the Board's i nformal mediation process. However, DM&E then sued WSOR, claiming WSOR did not have a right to serve the NAPCO facility. The United States District Court for the Western District of Wisconsin ruled in favor of access for WSOR under the agreements between DM&E and WSOR when the track was sold to WSOR, but stated in the alternative that, had the agreements between DM&E and WSOR not entitled WSOR to serve the facility, the Court would have ruled that the agreements violate the Rail Transportation Policy by attempting to keep NAPCO permanently captive to the DM&E. See Westlake's Initial Comments at 1-2, 34, *citing Dakota, Minnesota & Eastern Railroad Co. v. Wisconsin & Southern Railroad Co.*, No. 09-cv-00516-wmc, 2010 U.S. Dist. LEXIS 85695 (W.D. Wisc., Aug. 19, 2010), slip op at 19 n.12, *appeal pending*, No. 10-3177 (7th Cir.).

At the same time, Westlake believes that the financial condition of the railroad industry is sufficiently sound that the Board need not fear that its actions will make the railroads incapable of attracting capital (the statutory test for "rev enue adequacy"). Nevertheless, because the Board annually determines the railroads' rev enue adequacy, proper findings of the railroads' fin ancial needs[8] can be used to determine if the railroads continue to remain financially healthy. The Board is entirely capable of taking such matters into account in determining maximum reasonable rates or other terms of service, or in determining whether to provide shippers with relief in the form of reciprocal switching, terminal trackage rights, alternative routings, "bottle neck rates," access pricing, or any of the other remedies to which Westlake believes the shippers are entitled.

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[8] Westlake demonstrated in its Initial Comments that the Board's rev enue-adequacy standards are not correct, and should be replaced by a more accurate standard. One such standard is market-to-book ratios, as Professors Kahn and Hass endorsed. Westlake also emphatically disagrees with AAR that, for purposes of calculating a railroad's "re venue adequacy," the Board should use replacement costs. AAR Initial Comments at 17. As AAR acknowledges, the STB rejected that approach. *Ass'n of American Railroads – Petition Regarding Methodology for Determining Railroad Revenue Adequacy,* Ex Parte No. 679 (served Oct. 24, 2008). While the Board may have indicated that it finds replacement costs to be the superior approach as a matter of economic theory (a proposition with which Westlake disagrees, as did Professor Kahn in his seminal treatise, *The Economics of Regulation*), the Board was correct to conclude that replacement costs are not a practical approach to valuing regulated assets. In any event, if the Board were to use replacement costs (which are not generally known), it would have to replace the nominal cost of capital – which is difficult enough to calculate, as the Board knows – with the real cost of capital (a second unknown) -- which is even more difficult to measure – in determining railroad revenue adequacy. Otherwise, inflation in measuring asset value would be counted twice in the computation of an adequate level of revenues.

III.

TRUCK COMPETITION IS GENERALLY NOT AVAILABLE TO WESTLAKE OR MANY OTHER CHEMICAL SHIPPERS FOR MOST SHIPMENTS.

AAR (Initial Comments at 19) argues that truck competition remains strong. AAR acknowledges, however, that "it does not exist for all movements, and never has." *Id.* AAR was wise to acknowledge that, because many chemical shipments cannot, as a practical matter, move by truck. The great majority of Westlake's s hipments move in rail cars which can carry far more than a truck, making the economics of truck transportation prohibitive. Furthermore, shipping very large quantities of chemicals by truck would compound several burdensome problems already facing the nation – including congested roadways, deteriorating infrastructure, driver shortages and dependence on foreign oil – to name a few.

The reason Westlake is participating in this proceeding is because its shipments are, in nearly all instances, not truck-competitive. The Board should realize that, if shippers had effective transportation competition, they would avail themselves of it, and not hire counsel and consultants to assist them in determining what, if any, statutory remedies may be available to them before the Board.

The Board should also be aware that the numerous filings of community organizations, or of entities doing business with the railroads, or in some instances of shippers, who essentially filed "form letter s" endorsing the current regulatory system, are of course those who benefit from the current system. In any system in which competition exists in some markets, but not others, and where railroads seek some kinds of business but not others, and where some shippers benefit from differential pricing while others pay differentially higher rates, it is to be expected that some entities will at least perceive themselves as the "winners" in t he process. These are not the entities for which the Board exists; the Board exists to protect the captive shippers who are the paying higher rates, or enduring a lack of competition, or suffering from inferior service, because of their circumstances.

IV.

AAR ERECTS A STRAW MAN BY ARGUING THAT RAILROADS NEED TO CONTINUE USING DIFFERENTIAL PRICING; NO ONE DISPUTES THAT.

AAR defends differential pricing (Initial Comments at 22-23), even though the Board did not raise an issue about it, and no party, including Westlake, has suggested that differential pricing should be eliminated.

However, the circumstances in the railroad industry are far from that situation today. All studies seem to show that chemicals pay the highest rates. Recent rate proceedings before the Board show chemical rates over 1000% of variable costs in some instances, and rates above 500% are common, as the Board knows. This is a far cry from the rates on other commodities; the Board's Christensen Report concluded that somewhere between 14-29% of all traffic is still being carried below 100% of variable costs. This is not appropriate; all rates should at least equal 100% of variable costs, or else other traffic is cross-subsidizing the "below-water" (*i.e.*, below-100%) rates.

Ideally, all rates would pay the same markup, which today is about 130-145% of variable costs (*i.e.*, the fully allocated cost level), depending on the Class I railroad. But if all traffic cannot pay such rates, the remaining shippers are better off if the shippers with lower rates are at least covering 100% of the railroad's variable costs.

In any event, the jurisdictional threshold, depriving the Board of jurisdiction over rates less than 180% of variable costs, ensures that railroads will be able to continue to engage in differential pricing, because the fully-allocated cost level is approximately 130-145%, as discussed *supra*. Rates above fully allocated costs are differentially priced, by definition.

The Board should not be distracted by AAR's spurious arguments that shippers are arguing for the elimination of differential pricing, when that result is not even permissible under the Act.

V.

PROVIDING EFFECTIVE REGULATORY REMEDIES TO CAPTIVE RAIL SHIPPERS WILL NOT HARM OTHER SHIPPERS.

Finally, it is also important to understand that at least some of those entities who filed initial comments accepted the misguided conclusion in the

Board's Christens en Study, that if some shippers' r ates are reduced, other shippers' rat es will necessarily rise.[9] Their opposition to effective rail-to-rail competition and effective regulatory remedies in the absence of such competition appears to be based on the same conclusion as that of Christensen. Christensen's con clusion is erroneous, for three reasons.

First, it is based on the premise that the Class I railroads are barely "reven ue-adequate" today, and so would have to make up any lost revenue from other shippers. As Westlake has shown the premise is mistaken; the Class I railroads are financially healthy.

Second, the premise is actually illogical, because the railroads (assuming they are acting rationally) already should be maximizing their revenues from competitive shippers; therefore, if the Board were to prescribe a lower rate for a captive shipper, the competitive shippers could not be at risk of a rate increase, because they should already be charged the highest rate that their competitive circumstances will permit.

Third, the conclusion assumes that the railroad industry is static, *i.e.,* that its volumes will not grow, rates generally will not increase, and its productivity will not improve. None of that is true, at least in the long term. Aside from the recent recession, rail volumes have been growing for many years, and now are growing again. Also, rail rates generally increase, and

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[9] See, e.g., AAR Initial Comments at 7 ("As the Christensen Study concluded, 'th ere is little room to provide significant 'rate relief to certain groups of shippers without requiring increases in rates for other shippers or threatening the railroads' financial viability.' Christensen Study at ES-39.").

did so for the most part even during the recent recession. And, finally, the railroads have been steadily more productive since the Staggers Act was passed, as the Board's productivit y adjustment calculations in Ex Parte No. 290 (Sub-No. 4) demonstrate.

So, the Board should reject this conclusion of Christensen, which seems more an advocate's asserti on than a reasoned result of a dispassionate Study of the railroad industry. Because the Board paid for the Christensen Study, it is especially important to the perception of the Board as a dispassionate regulator that it rejects such an unsupported, inappropriate, and one-sided conclusion.

VI.

THE SPECIFIC FACTS OFFERED BY MANY SHIPPERS DEMONSTRATES THAT RAILROAD POLICIES ARE HARMING THE U.S. ECONOMY.

While the railroads and some of their supporters (many of whom are not shippers, but rather vendors doing business with the railroads, or entities such as ports or economic development agencies that work cooperatively with railroads on competitive transportation or development projects) offer generalities about the benefits of the current regulatory policies of the Board and the practices of the railroads, many captive shippers – for whom the Board exists – have demonstrated through specific facts that the Board's policies and the railroads' pra ctices are harming the U.S. economy. Westlake understands that the "Intereste d Parties" are summarizing those filings in their Reply Comments, so Westlake will not do so as well, but urges the Board to consider that the specific facts offered by many shippers disprove the conclusions offered by the railroads and their supporters.

Conclusion

For the foregoing reasons, the Board should (1) find that the railroad industry is financially strong and that Class I railroads, at least, are earning more than adequate revenues, (2) determine that shippers should have the right to route their shipments over alternative routings, (3) repeal the MidTec decision so that shippers do not have to prove "competitive abuse" to get competitive access, (4) promote reciprocal switching to encourage rail-to-rail competition, (5) overturn the "bottleneck rate" decisions so that shippers can require railroads to quote a rate between any origin and interchange point, or interchange point and destination, on their combined systems, and (6) establish pro-competitive access-pricing rules. The Board should declare that the impacts of these changes will be of benefit to the general economy, U.S. competitiveness, rail shippers, railroads, and the general public.

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